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IN THE

Supreme Court of the United States

DURA PHARMACEUTICALS, INC.; CAM L. GARNER; JAMES W. NEWMAN; CHARLES W. PRETTYMAN; WALTER F. SPATH; JAMES C. BLAIR; JULIA R. BROWN; JOSEPH C. COOK, JR.; and MITCHELL R. WOODBURY,

Petitioners,

v.

MICHAEL BROUDO; BALDEV S. GILL; LARRY MORGAN IRA; LEONID SHVARTSMAN (for G&S partnership); NEIL SISKIND; ROBERTA SPECK; BRENT VOGT, On Behalf of Themselves and All Others Similarly Situated,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

~~MOTION FOR LEAVE TO FILE~~ SUPPLEMENTAL BRIEF IN RESPONSE TO SOLICITOR GENERAL'S BRIEF FOR THE UNITED STATES AS *AMICUS CURIAE*; SUPPLEMENTAL BRIEF

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Respondents respectfully request leave to file the following supplemental brief in response to the Solicitor General's amicus curiae brief, which—respondents respectfully submit—misstates Ninth Circuit law and overstates the significance of the Question Presented on the record in this case.

Respectfully submitted,

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QUESTION PRESENTED

Whether a securities-fraud plaintiff invoking the fraud-on-the-market theory must demonstrate loss causation by pleading and proving a causal connection between the alleged fraud and the investment's subsequent decline in price.

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SUPPLEMENTAL BRIEF IN RESPONSE TO SOLICITOR GENERAL'S BRIEF

The Solicitor General perceives conflict among the circuits because he misunderstands—and misstates—Ninth Circuit law. This can be seen in the Solicitor General's assertions, for example, that following the Ninth Circuit's approach to loss causation means double-recovery windfalls for in-and-out traders. SG Brief at 11. The Solicitor General's assertions are flatly contradicted by controlling Ninth Circuit precedent, under which the investor who buys at an artificially inflated price, then sells at an inflated price, is deemed to recoup some or all of his loss and is denied a double recovery. "If the stock is resold at an inflated price,"

the Ninth Circuit holds, "the purchaser-seller's damages . . . must be diminished by the inflation he recovers from his purchaser." *Blackie v. Barrack*, 524 F.2d 891, 908-09 (9th Cir. 1975); *accord, e.g., Wool v. Tandem Computers, Inc.*, 818 F.2d 1433, 1437-38 & n.4 (9th Cir. 1987); *Green v. Occidental Petroleum Corp.*, 541 F.2d 1335, 1345-46 (9th Cir. 1976) (Sneed, J., concurring).

"For purchasers who sell *after* a disclosure which completely corrected the misrepresentations of the defendant, damages are determined only at the *time of purchase*." *Wool*, 818 F.2d at 1437 n.4 (court's emphasis). "For in-and-out traders, on the other hand, both the *time of purchase* and the *time of sale* are considered in determining recoverable damages." *Id.* (court's emphasis). The Ninth Circuit explained in *Wool*:

> Instead of determining the damages at the date of purchase, therefore, a two-step process is used when dealing with in-and-out traders. First, the spread between market price and value of the stock at the time of purchase is determined. When the purchaser sells the stock, the spread is again measured.

Id. "If the spread has diminished" the purchaser would recover the difference. *Id.* But not otherwise. The Ninth Circuit thus follows the very approach advocated by the Solicitor General—focusing on the relative level of inflation in a security's price, at both the time of purchase and of any subsequent sale.

While the Solicitor General suggests the Third Circuit's opinion in *Semerenko v. Cendant Corp.*, 223 F.3d 165, 185 (3d Cir. 2000), adopted a radically different position from the Ninth Circuit's, in truth the Third Circuit embraced and followed the Ninth Circuit approach articulated in Judge Sneed's *Occidental Petroleum* concurrence and applied in *Blackie* and *Wool*:

> In the absence of a correction in the market price, the cost of the alleged misrepresentation is still incorporated into the value of the security and may be recovered at any time simply by reselling the security at the inflated price. *See Green v. Occidental Petroleum Corp.*, 541 F.2d 1335, 1345 (9th Cir. 1976) (Sneed, J., concurring) (stating that an investor's proximate losses are limited to those amounts that are attributable to the unrecovered inflation in the purchase price).

Semerenko, 223 F.3d at 185.

This is the law applied by district courts in the Ninth Circuit.[1] And it is by no means an innovation of the Ninth Circuit. *See, e.g., In re LTV Sec. Litig.*, 88 F.R.D. 134, 148-49 (N.D. Tex. 1980) (cited with approval in *Basic Inc. v. Levinson*, 485 U.S. 224, 246 n.24 (1988)). There is no risk of double recovery in the Ninth Circuit—or anywhere else, for that matter.

After misstating Ninth Circuit law to produce imagined conflicts, the Solicitor General acknowledges that the real issue should not, in any event, be stated in terms of a "decline in price" as the Petition for Certiorari has it. *See* SG Brief at 12-13. "As formulated by petitioners, and by the courts in the cases on which petitioners rely," the Solicitor General writes, "the loss-causation standard requires a decline in the stock's price." SG Brief at 12. "That formulation may simply reflect the fact that, as in most securities fraud cases, there was in fact a decline in price in this case and the others that petitioners cite." SG Brief at 12-13. Indeed, as the respondents' Opposition to the Petition for Certiorari pointed out—the precedents are fact bound, their holdings fact specific.

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[1] *See, e.g., In re California Micro Devices Sec. Litig.*, 168 F.R.D. 257, 263 (N.D. Cal. 1996) (applying Ninth Circuit law, "both the time of purchase and the time of sale are considered"); *In re Cirrus Logic Sec. Litig.*, 155 F.R.D. 654, 661 (N.D. Cal. 1994) ("an in/out plaintiff recoups at least some of the loss incurred by the purchase because he both buys and sells during the period of price inflation"); *Hoexter v. Simmons*, 140 F.R.D. 416, 421 (D. Ariz. 1991) (following *Wool*).

The Solicitor General aptly states that the precedents therefore need not and ought not be interpreted to require such a price decline in every case: "A decline in price may not be a necessary condition for loss causation, however, because the inflation attributable to fraud could be reduced or eliminated even if there were a net increase in price." SG Brief at 13. "Thus, while it is ordinarily a decline in the price of stock that harms investors, they can also be harmed '[i]f a stock does not appreciate as it would have absent the fraudulent conduct,' so that their profit is smaller than it would otherwise have been." SG Brief at 13 (quoting *Gebhardt v. ConAgra Foods, Inc.*, 335 F.3d 824, 831-32 (8th Cir. 2003)).

The Solicitor General elaborates: "As Judge Easterbrook has observed, 'a firm that lies about some assets cannot defeat liability by showing that other parts of its business did better than expected, counterbalancing the loss.'" SG Brief at 13 (citing *Goldberg v. Household Bank, F.S.B.*, 890 F.2d 965, 966 (7th Cir. 1989)). That, of course, is the Ninth Circuit's position as well—that while a decline in price is one way of showing artificial inflation and loss, in our factually complex world it cannot be the only one.[2] This conclusion is entirely

[2] *See, e.g., Blackie v. Barrack*, 524 F.2d 891, 909 n.25 (9th Cir. 1975). In *Blackie*, when defendants argued "that the inflation paid must be measured by the change in price after a corrective release," the Ninth Circuit observed that such a "drop is of course circumstantial evidence of the inflation when purchased, but it is not the exclusive method of measuring inflation." *Id.* at 909 n.25. For in many cases "the drop after a corrective disclosure will not be conclusive of the amount of original inflation, both because the correction may be only partial (as is alleged of the major corrections involved here), and because the prolonged nature of the fraud introduces other market variables which may affect the amount the market reacted to disclosures at different times during the class period." *Id.* The Ninth Circuit's position turns out to be the same as the Solicitor General's—and the other Circuits. *Compare Knapp v. Ernst & Whinney*, 90 F.3d 1431, 1438 (9th Cir. 1996) (Wallace, J.), *with Goldberg*, 890 F.2d at 966 (Easterbrook, J.).

consistent with Judge Posner's opinion in *Bastian v. Petren Resources Corp.*, 892 F.2d 680, 682-83 (7th Cir. 1990), that an investor cannot point to a decline in price entirely unrelated to fraud and claim it as the measure of artificial inflation and loss.[3] The Ninth Circuit precedents similarly hold that those who point to a decline to prove loss must connect it to the fraud they allege.[4]

The Circuits and the Solicitor General thus agree in substance—that a decline in price is not necessarily required to show loss causation. They agree as well that a decline can be *relevant* to showing loss, however, and that plaintiffs who *do* rely on a decline in price to show loss eventually must connect it to the fraud alleged. The "conflict" in some language of the precedents turns out to be a fact-bound semantic dissonance.

Petitioners' Question Presented is not really presented in this case in any event. The Solicitor General says the case is ripe for review because the undisputed fact that Dura stock dropped over 20% when the FDA denied approval is not clearly pleaded. SG Brief at 17. It is, however, part of the record—based on the petitioners' own request for judicial notice. *See* ER79Ex.L. That request for judicial notice of Dura stock prices was both unopposed and wholly proper.[5] Petitioners placed the stock prices before the Ninth Circuit as well. *See* SER79Ex.L. And their Petition for Certiorari itself

[3] *See, e.g., Gray v. First Winthrop Corp.*, 82 F.3d 877, 886 (9th Cir. 1996) (discussing and distinguishing *Bastian*).

[4] *See, e.g., Heliotrope General, Inc. v. Ford Motor Co.*, 189 F.3d 971, 978 & n.12 (9th Cir. 1999); *Ambassador Hotel Co. v. Wei Chan Investment*, 189 F.3d 1017, 1027 (9th Cir. 1999); *Binder v. Gillespie*, 184 F.3d 1059, 1065-66 (9th Cir. 1999); *Provenz v. Miller*, 102 F.3d 1478, 1492 (9th Cir. 1996); *McGonigle v. Combs*, 968 F.2d 810, 820-21 (9th Cir. 1992).

[5] *See, e.g., La Grasta v. First Union Secs., Inc.*, 358 F.3d 840, 842 (11th Cir. 2004); *Ganino v. Citizens Utilities Co.*, 228 F.3d 154, 167 n.8 (2d Cir. 2000).

concedes: "Dura's share price declined somewhat following the November 3 announcement, from $12.375 to $9.75." Petition at 3 n.4. That is a deflationary drop—connected to the alleged fraud—of over 20%.

The record reveals that this 20% drop was on a partial disclosure, not a full disclosure of the facts, and that the stock would have dropped even further had Dura's press release not downplayed the significance of the FDA action that it presented as merely a temporary setback. *See* ER72 (Complaint ¶ 136). The FDA responded to the press release with a "notice of violation" warning petitioners that "[t]he Division of Drug Marketing, Advertising and Communications (DDMAC) . . . found that Dura's press release sent a message that 'misleadingly minimizes the fact that Dura must perform a completely new clinical [study]. . . .'" ER72 (Complaint ¶ 136, quoting FDA notice). Since the Ninth Circuit directed that leave to amend be given on remand, respondents soon will be filing an amended complaint demonstrating how the remaining inflation was removed from Dura's stock price over the following months, until Dura finally admitted that it had abandoned its Albuterol Spiros drug-delivery product as hopeless. That, of course, will moot whatever questions this Court might grant certiorari to resolve.

Such factual complications also underscore how inadvisable it would be—in any event—for this Court to adopt rules resolving intensely factual loss-causation issues as a matter of law *at the pleading stage*. The Solicitor General concedes that the price of a security need not necessarily decline for investors to have claims—and that the real analysis is of inflationary impact on market price as it fluctuates over time. SG Brief at 12-13. That presents questions of fact—and potentially messy ones, at that. *See Basic Inc. v. Levinson*, 485 U.S. 224, 248-49 & n.29 (1988); *Gebhardt*, 335 F.3d at 832; *Blackie*, 524 F.2d at 909 n.25. Determining when and how information affected stock price

is by no means a task so simple that it may be decided on the pleadings—surely not by simplistically pairing specific price movements and disclosures. Economists warn that stock prices may reflect new information before it is formally announced.[6] That is no secret to this Court, which in *Dirks v. SEC*, 463 U.S. 646, 649-50 (1983), noted that surreptitious stock sales by investors with access to adverse inside information regarding a company's accounting improprieties drove its stock from $26 per share to less than $15 per share in two weeks—causing the New York Stock Exchange to halt trading—before any public disclosure of the accounting fraud.[7] In other cases the market's reaction to a corporation's announcements may be delayed, as it takes time for an opaque disclosure's real significance to sink in. For as this Court has noted, "not every mixture with the true will

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[6] *See, e.g.*, Burton G. Malkiel, *A Random Walk Down Wall Street* 192 (8th ed. 2003) ("Research indicates that, on average, stock prices react well in advance of unexpectedly good or unexpectedly bad earnings reports."); William F. Sharpe & Gordon J. Alexander, *Investments* 522 (4th ed. 1990) (Nobel laureate summarizes research showing that "prices of firms that announced unexpectedly low earnings ... tended to decrease prior to the announcement"); James H. Lorie, Peter Dodd & Mary Hamilton Kimpton, *The Stock Market: Theories and Evidence* 100-02 (2d ed. 1985) (citing research indicating that price adjustments begin in advance of formal earnings announcements); Sara Fisher Ellison & Wallace P. Mullin, *Gradual Incorporation of Information Into Stock Prices: Empirical Strategies*, National Bureau of Economic Research Working Paper No. 6218, at 4, 13-17 (Oct. 1997) (price effects seen weeks in advance of merger announcements); Ray Ball & Phillip Brown, *An Empirical Evaluation of Accounting Income Numbers*, 6 J. Acctg. Res. 159, 160-70 & Fig. 1 (1968) (earnings reports).

[7] *Dirks*, 463 U.S. at 649-50; *see also Dirks v. SEC*, 681 F.2d 824, 831-32 (D.C. Cir. 1982), *rev'd*, 463 U.S. 646 (1983). In *SEC v. Shapiro*, 494 F.2d 1301, 1307 n.3 (2d Cir. 1974), the Second Circuit similarly noted that trading by insiders who knew of *undisclosed* favorable information "pushed the price of [the] stock by February 18 to nearly three-and-one-half times what it had been at the beginning of the year."

neutralize the deceptive. If it would take a financial analyst to spot the tension between the one and the other, whatever is misleading will remain materially so . . . ." *Virginia Bankshares v. Sandberg*, 501 U.S. 1083, 1097 (1991).

When and how information entered the market and affected stock prices is a matter for detailed evidence and careful analysis by expert witnesses and triers of fact—not for decisions on the pleadings. *See Basic*, 485 U.S. at 249 n.29 ("[p]roof of that sort is a matter for trial"); *Gebhardt*, 335 F.3d at 832. The point is underscored, to say the least, by the far greater complexity of other securities cases currently in the news—in which defendants hope to escape liability by demanding that "loss causation" be decided on the pleadings.[8]

The Petition for a Writ of Certiorari should be denied.

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[8] *See, e.g.*, *Fogarazzo v. Lehman Brothers, Inc.*, No. 03 Civ. 5194, 2004 U.S. Dist. LEXIS 9193, at *28-*50 (S.D.N.Y. May 21, 2004); *In re AOL Time Warner, Inc. Sec. & "ERISA" Litig.*, MDL No. 1500, No. 02 Civ. 5575 (SWK), 2004 U.S. Dist. LEXIS 7917, at *96-*97 & n.39 (S.D.N.Y. May 5, 2004); *In re Enron Corp. Sec. Litig.*, No. MDL-1446, Civ. No. H-01-3624, 2004 U.S. Dist. LEXIS 8157, at *17-*23, *34-*36 (S.D. Tex. Mar. 29, 2004); *In re WorldCom, Inc. Sec. Litig.*, 294 F.Supp.2d 392, 428-29 (S.D.N.Y. 2003).

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